Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Kuehl	Analyst:	Jeani Brent	Bill Number:	AB 484
Related Bills:		Telephone:	845-3410	Amended Date:	04/05/1999
		Attorney:	Doug Bramhall	Sponsor:	

SUBJECT: Qualified Labor Costs Paid for Production, Development, or Distribution of Television Program or Movie Refundable Credit

SUMMARY

This bill would allow taxpayers engaged in the production, development or distribution of motion picture and television production to claim a refundable credit equal to 6% of specified production labor contract costs of qualified property.

SUMMARY OF AMENDMENT

The April 5, 1999, amendments would strike the bill’s language that would have allowed taxpayers a credit equal to an unspecified percentage of the cost of developing and distributing intellectual property and would insert the refundable credit discussed in this analysis.

EFFECTIVE DATE

As a tax levy, this bill would become effective immediately and would apply to taxable or income years beginning on or after January 1, 1999.

RELATED BILLS

AB 1062 (1997/98), AB 2798 (Stats. 1998, Ch. 323), AB 358 (1999/00).

SPECIFIC FINDINGS

Existing **state and federal laws** allow a taxpayer to deduct expenses paid or incurred in the ordinary course of a taxpayer’s business (e.g., employee wages and benefits).

Existing state law provides various tax credits that are designed to provide tax relief for taxpayers who must incur certain expenses (e.g., renter’s credit) or to influence behavior, including business practices and decisions (e.g., research credits). For instance, taxpayers engaged in a trade or business in an economic development area are allowed a hiring credit for a certain percentage of qualified wages paid to qualified employees.

This bill would allow taxpayers engaged in the production, development or distribution of motion picture and television production to claim a refundable credit equal to 6% of the “qualified costs” of “qualified property.”

Board Position:			Department Director	Date
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“Qualified costs” would include any production labor contract performed in the state that is capitalized in the production, development or distribution of motion picture and television production and is:

1. Paid pursuant to a collective bargaining contract; or
2. Paid in an amount equal or greater than the amount specified in a current collective bargaining agreement.

“Qualified property” would mean motion picture production and television productions that are under $5 million in total cost and are one of the following:

1. Movies of the Week, which include but are not limited to “made for television,” “made for cable,” “direct to video;” or
2. Pilots, which include, but are not limited to, “single camera” productions.

When more than one qualified taxpayer is engaged in the production, development or distribution of a motion picture or television production, each qualified taxpayer would be allowed a pro rata share of the refundable credit based on equity.

POLICY CONSIDERATIONS

This bill would raise the following policy considerations.

1. Historically, refundable credits (such as the state renter’s credit, the federal Earned Income Tax Credit and the federal farm gas credit) have had significant problems with fraud.

2. This bill would allow taxpayers located within an enterprise zone to claim this credit and the enterprise zone credit hiring credit based on the same wage amounts. The enterprise zone credit provisions do not restrict the taxpayer to one credit based upon a single employee.

3. Incentives are typically designed to encourage future behavior. This bill would give a credit for wages already paid (from January 1, 1999) and for employees currently employed in the production of movies or television programs.

4. This bill defines “qualified property” as either movies of the week and pilots. This definition appears to exclude on-going television programs.

5. Conflicting tax policies come into play whenever a credit is provided for an expense item for which preferential treatment is already allowed in the form of an expense deduction. This bill would have the effect of providing a double benefit for deductible wages and salaries. On the other hand, making an adjustment to limit deductions or reduce basis in order to eliminate the double benefit creates a state and federal difference, which is contrary to the state’s general conformity policy.

6. This bill does not specify a repeal date. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness.

Implementation Considerations

This bill would raise the following implementation considerations. Department staff is available to assist the author with any necessary amendments.

1. The department has not administered a refundable tax credit under the Personal Income Tax Law (PITL) since the refundable renter's credit was suspended in 1993. The department has never administered a refundable tax credit under the B&CTL. Establishing a refundable tax credit program would have a significant impact on the department's programs and operations and require extensive changes to forms and systems.

2. With respect to the B&CTL refundable credit, the bill provides no guidance as to whether the credit would be allowed to reduce alternative minimum tax and the $800 minimum franchise tax to zero. Generally, credits cannot reduce these amounts. The lack of guidance could cause disputes between taxpayers and the department.

3. It is expected that the department manually would review the claims for refunds and attached documentation since the credit refund amounts could be significant.

4. This bill would define "qualified cost" as any production labor contract that is capitalized in the production, development, or distribution of a motion picture. Since the costs are tied to a "production labor contract," the bill leaves unclear whether "qualified costs" include only those costs associated with production or includes costs also associated with development and distribution.

5. This bill defines a "qualified taxpayer" as one engaged in the production, development, or distribution of a motion picture or television production. The bill leaves unclear how a taxpayer who merely develops or distributes, but does not produce, a film, could incur "qualified costs," if "qualified costs" include only those costs associated with production.

6. The terms "production labor contract," "production, development and distribution," and "equity" are not defined. For example, the use of "equity" in discussing how a credit would be shared among taxpayer is unclear and may cause disputes between taxpayers and the department.

7. This bill states that credit would be allowed for the qualified cost for qualified property. However, the credit in this bill is not a credit for "qualified costs for qualified property" – rather, the credit fundamentally is a "wage credit" for wages paid to produce certain motion pictures and television shows. It would help the department in administering this credit if the terminology is changed to reflect this fact.

8. This bill does not modify the hierarchy of B&CTL tax credits (Section 23036), thus the order in which credits would be applied before this credit would be refunded is unclear. The existing hierarchy under PITL includes refundable credits (Section 17039).

FISCAL IMPACT

Departmental Costs

The department's costs to administer this bill cannot be determined until implementation concerns have been resolved, but are expected to be significant.

Tax Revenue Estimate

The revenue impact of this bill is estimated to be as shown in the following table:

Revenue Impact of AB 484, As Amended April 5, 1999 Effective January 1, 1999 Assumed Enacted after June 30, 1999 $ Millions		
1999-0	2000-1	2001-2
($356)	($483)	($553)

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Tax Revenue Discussion

The revenue impact of this refundable credit would depend on the amount of qualified wages. Qualified wages are wages paid to California employees of the movie production industry.

The amount of qualified wages is estimated as the product of the number of qualified employees and the average wage. The number of qualified employees was estimated from data provided by the California Employment Development Department (EDD). According to EDD, total employment for SIC Code 781 (Motion Picture and Video Tape Production) was 143,300 in 1998.

EDD also provides average weekly earnings for people employed in SIC Code 78 (Motion Pictures). EDD data also reveals that the average annual growth rate of employment in SIC 78 was 6.6% and weekly wages was 6.6% for the period 1995 through 1998. These growth rates were used for projecting qualified costs for the out years of this bill. From this data it was calculated that total wages paid in California for workers within SIC 781 amounted to $10.5 billion during 1999 (143,300 employees growing at 6.6%, at $1,377 per week for 50 weeks). This amount was further discounted by 45% to account for the collective bargaining requirement, officers' salaries, and the $5 million production cap.

The revenue loss for 1999, the first taxable year, is projected to be $350 million as follow:

$10,517 mil. in qualified wages * 6% credit rate * 55% = $350 mil.

The increase in revenue losses in 2000/01 as compared to 1999/00 is primarily due to the pattern of payments and refunds that is expected to arise from this bill. Because, in general, changes in payments/refunds that accompany returns are not realized until the second fiscal year of a tax law change, the revenue effect in the second fiscal year exceeds that in the first fiscal year.

Further, because the credits is refundable, most of the credits that are generated due to this bill would be used only when taxpayers' final returns are filed and would not affect estimated payments. Therefore, in the 1999/2000 fiscal year, the calendar-year corporations with tax years beginning in 1999 (with the exception of those filing on extension) would receive their credit refunds by the end of June 2000. Likewise, in the 1999/2000 fiscal year, only some of the fiscal-year corporations with tax years beginning in 1999 would receive their credit refunds by the end of June 2000. Thus, the 1999/2000 fiscal year estimate represents less than a full liability-year estimate. For subsequent fiscal years, however, a full liability-year would be represented. Thus the 2000/2001 fiscal year corresponds to a complete liability year and includes a portion of the refunds for 1999 fiscal filers.

BOARD POSITION

Pending.

At its March 23, 1999, meeting, the Franchise Tax Board voted 2-0 to take a neutral position on this bill, as introduced February 18, 1999. The Franchise Tax Board's position for the proposed amendments is pending.